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IN THE

Supreme Court of the United States

OCTOBER TERM, 1946

No. 208

TRANSPARENT-WRAP MACHINE CORPORATION,

Petitioner,

v.

STOKES & SMITH COMPANY,

Respondent.

PETITIONER'S REPLY TO GOVERNMENT BRIEF

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PETITIONER'S REPLY TO GOVERNMENT BRIEF

There is no justification or reason for now establishing a special rule for patent owners making it illegal to acquire patents as an incident to a patent license.

The Government asks this Court to lay down a broad rule that in all cases, irrespective of purpose or effect, acquisition of an improvement patent by a condition in a patent license is illegal. It would have this Court thus establish that conduct in itself legal becomes illegal merely because included in a patent license.

Such a rule would not strike at possible evils resulting from misuse of patents but would create a rule of illegality which would unfairly discriminate against patent owners as a class in a freedom of contract which is enjoyed by all and which is specifically conferred by Statute. A blanket prohibition against acquiring patents as a condition in a patent license is no more effective as a means of preventing violations of public policy than a blanket prohibition

against acquiring patents which this Court, in the *Hartford-Empire* case[1], held was inappropriate. The legality or illegality of acquisition of improvement patents does not turn on whether they are acquired as an incident to a license granted by a patent owner but on the effect of the acquisition on the public interest. This varies with the facts of each case and is governed by the general law.

Assignment, and hence acquisition by assignment, of improvement patents is clearly legal in itself. The statute so provides (35 U. S. C. 47). Direct grant, and hence acquisition by direct grant of improvement patents is also clearly legal in itself. And the statute so provides (35 U. S. C. 31). It is conceded by the Government that it has long been the law that improvement patents may be legally acquired from employees hired to invent (brief p. 11).

Neither the statutes nor the law suggests that there is any limitation on this right whereby one is debarred from acquiring such patents because he is already a patent owner or because he acquires improvement patents as part consideration for the grant of a patent license. There is no public interest which so requires, Congress has not so limited the statutes, and the decisions for over 60 years are to the contrary. If the rule is to be changed, it should be changed by Congress and apply only to future transactions instead of being changed by a retroactive declaration of illegality upsetting the multitude of interests already vested in reliance on the existing rule.

There is, however, no reason to change the law. When the public interest becomes involved because of acquisition of a number of patents, the matter of substance is the *effect* of the acquisition, not the *fact* of acquisition or the *manner* of acquisition. This was specifically recognized by this Court in the *Hartford-Empire* case in which this

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[1] *Hartford-Empire Co.* v. *United States*, 323 U. S. 386, 431 (1945).

Court condemned the monopoly and restraints resulting from a particular concentration of patents, and imposed certain restrictions on future use of those patents in the illegally monopolized fields, *but specifically amended the lower court's injunction so as to permit any defendant to include in its patent licenses in other fields a provision for the acquisition of improvements from its licensee.*

The Government in its brief (p. 14) incorrectly states, we think, the holding in the *Hartford-Empire* case. That case did not involve, as the Government says, merely a "failure of this Court to extend the injunction" but constituted a holding that the existing injunction *was too broad and that it should be amended* "to permit any appellant, corporate or individual, to retain and refuse to license, to use and refuse to license, or to license with restrictions, any patent hereafter applied for or acquired *except those* applicable to feeders, formers, stackers and lehrs and processes and methods applicable thereto". 323 U. S. at p. 424. Italics ours. The legality of such license provisions *per se* was not only an issue raised by the parties (see the quotations from the briefs in that case set forth at pp. 29-30 of our main brief) but the very arguments now adduced were there adduced (see Gov't Brief on reargument pp. 153-4, 165 and Gov't main brief pp. 225-7, 246-7, 377-8). The Court's attention was thus clearly directed to the matter but, even if it had not been, we think the Court would hardly have amended the decree in recognition of this freedom of contract if the provisions were *per se* illegal.[1]

Under the existing law, the lower courts have no difficulty in distinguishing illegal from legal acquisition irrespective of the form of the transaction. For example, in the *Parker-Rust Proof case*[2], the court distinguished two transactions for acquisition of patents and held one legal

[1] *Oscanyan* v. *Arms Company*, 103 U. S. 261 (1880).

[2] *United States* v. *Parker-Rust-Proof Co.*, 61 F. Supp. 805 (E. D. Mich S. D. 1945).

and the other illegal—in each instance, *because of its effect* and without any regard to whether accomplished as an incident to a patent license.

The so-called *Carbice* cases do not suggest that a legal practice becomes illegal because included in a patent license. The practices condemned in those cases were in and of themselves illegal restraints of trade irrespective of the method by which they were accomplished and the doctrine of those cases has no application here where the conduct and result are legal.

The foregoing, we think, completely disposes of the Government's fundamental contention that there should be a rule of law that it is illegal to acquire improvement patents pursuant to a condition in a patent license.

However, lest we be thought to agree with incidental contentions of the Government, we note our views in the following:

The Government ignores the facts.

The Government in alluding to the facts

(a) ignores the fact that the ownership of the patents by petitioner rather than respondent does not decrease the public's rights—the public could not infringe them in either event. The case presents merely a question as to which of two parties is to own the patents.

(b) ignores the fact that petitioner has interests in foreign fields that made it important that the inventions be disclosed to it and that the United States patents be prosecuted by it.

(c) ignores the joint nature of the transaction under which the respondent was to use its best efforts to promote the business, the petitioner was to turn over the existing business and supply

"know-how", and both were to share the profits equally.

(d) ignores the fact that the business, having been transferred as a complete going concern, was to be retransferred as a complete going concern.

(e) ignores the fact that, at all times, whether respondent was in or out of the business, respondent had, and was to continue to have, full right to use the improvement inventions in its own business and to license others to so use them. There was no hardship on respondent.

(f) ignores the fact that respondent's breach of contract was not due to hardship or illegality or to any belief on its part, or its counsel's, that there was any hardship or illegality. The agreement was not only freely entered into by respondent but resulted from its representations that it would try to improve the machine for the benefit of the business and that it was better equipped to do so than petitioner. The illegality *now* alleged was a mere afterthought in an attempt to secure the benefits of the agreement and avoid one of its fair obligations.

The doctrine of the *Carbice* case does not apply.

The Government's attempt to expand the doctrine of the *Carbice*[1] and related cases to cover the present case glosses over or misstates matters of importance.

(a) *The essential difference between those cases and the instant case is that the practices there condemned are* per se *contrary to the public interest irrespective of how accomplished whereas here they are* per se *explicitly permitted by statute.*

[1] *Carbice Corp.* v. *Am. Patents Corp.*, 283 U. S. 27 (1931).

In the *Carbice* cases the practices involved were in and of themselves illegal as restraints of trade, namely attempts to monopolize commodities which were unpatented or, if patented, which had been sold with the consent of the patentee and hence were free from the patent. The acts were *per se* contrary to public policy. In the anti-trust cases involving such practices, as well as in the so-called *Carbice* cases, this Court not only condemned the practices but held that they were not justified by the patent laws. In the present case, on the contrary, the practices are in themselves legal and require no justification, and the fundamental principle of the *Carbice* cases does not apply.

The Government, in an attempt to make the *Carbice* decisions applicable, asserts that a practice need not violate the anti-trust laws in order to come within the *Carbice* line of cases, but examination of the two cases cited by the Government shows that in these two, as in the others, the practices condemned were clearly contrary to public policy as embodied in or underlying the anti-trust laws.

In one of the cases, the *Motion Picture Patents case*,[1] the Court stated that it is contrary to public policy to restrain trade by attaching a restriction to an article sold in the free channels of trade and also is contrary to public policy to attempt to monopolize unpatented articles; the latter was supported by reference to the Clayton Act; the former, as stated by the Court in *Straus* v. *Victor*[2] decided the same day, had been "hateful to the law from Lord Coke's day to ours."

Similarly in the other of the two cases, the *Morton Salt* case,[3] this Court held that, restraint of trade in unpatented

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[1] *Motion Picture Patents Co.* v. *Universal Film Mfg. Co.*, 243 U. S. 502 (1917).

[2] *Straus* v. *Victor Talking Mach. Co.*, 243 U. S. 490 (1917).

[3] *Morton Salt Co.* v. *G. S. Suppiger Co.*, 314 U. S. 488 (1942).

articles being contrary to public policy, it was unnecessary to consider whether sec. 3 of the Clayton Act was specifically violated, and, in the later *Hartford-Empire* case, referred to the *Morton Salt* case and specifically stated (323 U. S. at 415) that the conduct there was contrary to the anti-trust laws. It was so construed in *United States* v. *International Salt Co.*, S. D. N. Y. decided November 20, 1946, 71 U. S. P. Q. 262, where Judge Rifkind stated (p. 265) "The misconduct which disqualified the plaintiff in the *Morton* case from enforcing his patent right was interference with the system of free competition."

In the present case the objectives of the agreement, acquisition of improvement patents, are permitted by statute. They are not contrary to the public interest and neither the *Carbice* cases, nor any other cases based on protecting the public against restraint of trade, apply.

(b) *The Government asserts that acquisition of an improvement patent expands and prolongs the monopoly of a patent already held. But this is not so.*

Each patent stands on its own feet and constitutes an independent grant based on an independent invention. As each patent expires the public acquires the right to use the particular invention of that patent and this is all it bargained for.* It would be contrary to the express terms of the later patent grant and contrary to the purpose of the patent system to permit the invention of the later patent to be used merely because an earlier one had expired—and this is not altered because the later patent covers a more desirable form. There is no hardship on

* "All that the patent law requires is that when a patent expires the invention covered by that patent shall be free to every one, and not that the public has the right to the use of any other invention, the patent for which has not expired, and which adds to the utility and advantage of the instrument made as the result of the combined inventions." *United States* v. *American Bell Telephone Co.*, 167 U. S. 224, 249 (1897). See also *Hartford-Empire Co.* v. *United States*, *supra*, at page 432.

anyone in this, but only fair dealing, and the Government in calling it (p. 9) "this unfortunate result," is not only guilty of loose thinking but is flying directly in the face of the fundamentals of the patent system. The patent system is based on the hope that later inventions will be more desirable and, to that end, grants a separate 17-year monopoly for each improvement.

The Government cites the *Scott* v. *Marcalus* case[1]. Certainly it is not necessary to cite that case to establish the law that upon expiration of a patent the public is free to practice what was formerly covered thereby. Although such freedom most certainly exists, it does not justify the public in infringing later patents validly granted for improvements thereon and there is nothing in the *Scott* case which so holds or intimates. It is sheer perversion of fact and distortion of language for the Government to say that the present contract will cause respondent, or anybody else, to pay for the privilege of using the inventions of expired patents if they acquire the privilege of using the inventions of later granted improvements patents.

The Government must be imagining situations where the patents might possibly be misused after they are acquired but such imagined misuses do not automatically or inevitably arise because of mere acquisition or because of the method of acquisition. Moreover, if they are going to arise, they can arise irrespective of the method of acquisition, namely, whether acquired by direct grant of the Government, by outright purchase, by employment of inventors, or as part consideration for a patent license. A particular method of acquisition need not be, and should not be, outlawed merely because the patents may *possibly* be used illegally when, even more readily and probably, they may be used legally. If there be deemed to be some great latent public interest requiring that

[1] *Scott Paper Co.* v. *Marcalus Mfg. Co.*, 326 U. S. 249 (1945).

patent licenses be put in a class different than other contracts, the change in the law should come from Congress. Yet, though strenuously and repeatedly urged by the Department of Justice, Congress has declined so to legislate (S. 2491, S. 2730, H. R. 109, H. R. 3874, 78th Congress; H. R. 97, H. R. 3642, 79th Congress).

(c) *The Government argues that mere concentration of patents in the hands of a single owner, not only may be, but is, objectionable. This Court has held to the contrary.**

The Government cites no inevitable objectionable result. Nor does it say at what degree of concentration any possible objectionable result would appear. Is it 1, or 2, or 10, or 100 patents? If there could conceivably be any arbitrary limit to the number of patents proper for a single owner to acquire, Congress must set it.

This Court in the *Hartford-Empire* case, at p. 431, held that a blanket injunction against acquisition of patents was "inappropriate to restrain future violations of the anti-trust statutes."

The Government seems to think there is something wrong in the fact that the agreement could continue for an indefinite period of time because the Government thinks respondent would be hesitant to exercise its right to terminate. Any hesitation by respondent to terminate would be based not on improvement patents made by respondent (since it is free to use these in its business in any event**).

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* *United States* v. *American Bell Telephone Co.*, 167 U. S. 224, 249 (1897); *United States* v. *Winslow*, 227 U. S. 202, 217 (1913); *United States* v. *United Shoe Mach. Co.*, 247 U. S. 32, 51, 53, 54 (1918); *Hartford-Empire* v. *United States*, *supra*, p. 431.

** Paragraph 11 of the agreement (R. 99, fol. 297), after stating that licensor's rights are exclusive only with respect to Transwrap machines, provides: "* * * Licensee shall have the free right to use and enjoy them in all other fields and in all other kinds and types of machines without the payment of any royalty to Licensor for such use."

Paragraph 12 similarly provides (R. 100, fol. 300): "The Licensee shall have the full right to use and enjoy any of the said inventions in its other machines which do not compete with Transwrap Packaging Machines and to license others so to do, * * *."

but on the fact that the business is profitable and a good one to be in. There is no public interest involved here. Nor is there any hardship on respondent, and it has urged none. The contract was freely made.

The Government seems to think that there is something wrong *per se* with "continuous accretions to the patent holdings of licensor", "licensor", of course, meaning "the business." On the contrary, such a result is a normal result contemplated by the patent system.*

Moreover, it does not depend on whether petitioner operates the business or respondent operates the business or whether the inventions are made by respondent or petitioner's employees under contract. Stimulation of invention being one of the purposes of the patent system, it would seem (contrary to this view of the Government), to be desirable that continuous additional inventions be made irrespective of who makes them or who eventually owns them. As we have said, if the resulting patents are misused, the matter can be dealt with under the existing law as the facts may justify.

(d) *The Government asserts that the contract destroyed the incentive to invent and hence that it is contrary to the purpose of the patent system. But this is contrary to the fact as our main brief points out* (p. 20).

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* Thus in *United States* v. *American Bell Telephone Company*, 167 U. S. 224, this Court found no objection to the acquisition of supplementary patents saying:

> "Much is said in the briefs and in the arguments about the practical continuance of the telephone monopoly. * * * the public, which always insists on having the best and most serviceable, will undoubtedly take the new instrument, and in that way it may happen that what is called the telephone monopoly is practically still further continued. But surely that does not abridge the legal rights of any one. The inventor of the latest addition is entitled to full protection, and if the telephone company buys that invention it is entitled to all the rights which the inventor had" (p. 249).

The Government attempts to support this by distinguishing from the case of an employee saying,

> "the encouragement to invent on the part of the employee comes from the payment of a salary in return for his efforts and the realization that his salary will cease if he fails to produce."

But the same incentive exists in this case. Respondent profits by invention since it not only gets its costs and a normal manufacturing profit on increased sales but also equally shares the net profit thereon. Moreover, like the employee, if it failed to conduct research, its prospect of profits could be cut off; the business is kept ahead of competition by making improvements and, moreover, unless respondent used its best efforts to promote the business, the agreement might be terminated (R. 95, fol. 283, see also our main brief, p. 20; also, our reply to respondent's brief, p. 4).

(e) *The Government urges that petitioner's interests will be adequately protected if it gets a mere license but this loses sight of the facts.*

The patents are an adjunct of the business, the improvements covered thereby were developed for the benefit of the business, and were developed under an agreement entered into because of respondent's representations that it would use its best efforts to promote the business and that it was better equipped than petitioner to make improvements. Petitioner placed in respondent's hands, and took from its own hands, the day to day opportunity to observe defects and make improvements indicated to be desirable. A mere license would not only be inequitable and contrary to the agreement but would not protect the business against appropriation of the inventions by others. The Government would leave the patents in respondent's hands where they not only could not be used for their intended purpose

in protecting the business but could be used by respondent against the business. As we have pointed out in our main brief (footnote p. 16) equity would not permit such a breach of confidence even if there were no explicit agreement.

Conclusion

The Government is unsound in its contention that there should be established a new rule that it is illegal to acquire improvement patents as an incident to a patent license.

Respectfully submitted,

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